Supreme Court, U. S.
FILED
JAN 24 1980
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

No. 79-1037

In the Matter of:

SOUTHWEST RESTAURANT SYSTEMS, INC., an Arizona corporation, dba PINNACLE PEAK PATIO,

---

STOCKTON & HING,

Petitioner,

vs.

JOHN EVANS, Trustee of SOUTHWEST RESTAURANT SYSTEMS, INC., and HARVEY R. McELHANON, JR., and DOREEN T. McELHANON, his wife,

Respondents.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

POWELL B. GILLENWATER,
Attorney for Respondent
of:
GILLENWATER & MEYERS, P.C.
3242 North 16th Street
Phoenix, Arizona 85016

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STATEMENT OF FACTS

There are so many material facts omitted from Petitioner's statement that Respondents are compelled to restate the controlling facts:

The judgment of the 9th Circuit Court of Appeals affirmed the August 19, 1977 order of the United States District Court for the District of Arizona, affirming the Bankruptcy Court order of May 6, 1977. The Bankruptcy Court authorized interim distribution to stockholders pursuant to an order confirming a plan of sale and distribution entered on October 14, 1975.(R.13) The order confirming the Debtor's plan was initially appealed by petitioner's STOCKTON & HING (R.13). However, the appeal was voluntarily dismissed (R.33) and the order confirming the plan became final on November 13, 1975. The plan provided that after the payment of all creditors the remaining proceeds would be distributed to the stockholders after deducting all offsets and liabilities owed to the debtor corporation by the stockholders.

At the very outset of the reorganization proceedings, the Trustee instituted litigation to determine the stock ownership of the debtor corporation. On April 16, 1975 the Trustee's attorney submitted a stipulation regarding stockholder ownership and voting rights (R.1) to Robert Hing, Esquire, a member of Petitioner's law firm. The third paragraph of the stipulation originally stated that the law firm claimed "a possessory lien on the stock mentioned above to secure attorneys fees." Mr. Hing, on the law firms behalf, inserted an interlieniation in the paragraph which made it read as follows:

> "That the firm of Stockton & Hing claim a possessory or retaining lien on the stock mentioned above to secure attorneys fees, for which a claim has been filed herein (R.2)."

Pursuant to the stipulation, an order was entered by the United States District Court (R.10) stating:

> ". . . .that respondents Robert Ong Hing and Stockton & Hing and Judith N. Boccaccio have no ownership interest in the stock of Southwest Restaurant

> Systems, Inc., nor any right to vote any of the shares of stock of said corporation in these proceedings."

This order became final and was not appealed by Stockton & Hing, despite the fact that they were parties to the proceeding to determine stock ownership.

In Stockton & Hing's notice of appeal from the order confirming the plan which was later voluntarily dismissed, Stockton & Hing stated:

> "Stockton & Hing, an unsecured creditor of the bankrupt corporation and holder of an attorneys lien on two-thirds of the stock of the bankrupt corporation appeals * * *" each of the claims filed by Stockton & Hing in the reorganization proceeding and in each of the individual bankruptcies of Greer and Harris described their interest as an attorneys retaining lien.(r.11)

Petitioner however, objected to the order authorizing interim distribution, claiming a lien upon the sales proceeds by virtue of possession of stock certificates of two stockholders. At the time this objection was made, two former stockholders had no right to receive

any of the distribution proceeds by reason of unsatisfied judgments against them which under the plan of reorganization was to be set off against any amounts they would receive in interim distribution.

The District Court in ruling on Stockton & Hing's right to share in interim distribution held:

> "Stockton & Hing argue that their lien interests are superior to the trustee's power to offset. However, Stockton & Hing can demonstrate no claim against the trustee and advance no reason why the trustee must account for their interests apart from the rights of Greer and Harris. Moreover, the October 14th order modifying rights in the stock is unassailable. 11 U.S.C. Section 616(1) authorizes reorganization plans under Chapter X to alter the rights of stockholders. A bankruptcy court has the further equitable power to subordinate the stock claims of negligent directors, or directors who breach fiduciary duties owed to the debtor corporation, to the claims of other stockholders. In re Automatic Washer Co., 226 F.Supp. 834,836 (S.D. Iowa 1964), aff'd. 338 F.2d 1006 (8th Cir. 1964); In re Texas Portland and Cement Co.,205 F.Supp. 159162 (E.D. Tex. 1962). Stockton & Hing's retaining lien grants them no greater interest than the Bankruptcy Court accorded Greer and Harris." (R.402,403)

In that opinion the Court further distinguished its previous opinion of In re Charles Harris as follows:

> "Although Charles Harris, in dictum, referred to Stockton & Hing's interest in the stock as a security interest, the Court did not face the issue of priority and hence, did not characterize Stockton & Hing's interest.
>
> U.S.C. Section 9-104(c) specifically excludes common law liens for services from the scope of article nine. See A.R.S. Section 44-3104(3). Stockton & Hing are not article nine creditors. Rather, Stockton & Hing's rights in the stock are those of a common law attorney's retaining lien." (R.401)(emphasis added).

The Trustee's plan and order confirming the plans specifically cancelled the stock of Southwest Restaurant Systems, substituting a prorata share of distribution, subject to offset. The plan of sale and distribution was voted on and approved by two-thirds majority of every class of creditors, including the class of which petitioners were members. The plan and order confirming the sale became final and binding on all parties on November 13, 1975.

A PLAN OF REORGANIZATION APPROVED BY THE REQUISITE NUMBER OF CREDITORS AND STOCKHOLDERS AND CONFIRMED BY THE COURT IS BINDING ON ALL CREDITORS AND STOCKHOLDERS AND ALL PERSONS CLAIMING THROUGH THEM.

In this case the plan of reorganization was approved by two-thirds vote of the stockholders of the debtor corporation after proceedings has been held to determine exactly who were stockholders of the corporation. Stockton & Hing were made parties to the former proceedings and specifically stipulated that they did not claim any ownership interest in the stock or any right to vote the stock. Further, Stockton & Hing appealed from the order confirming the plan aserting that they held an "attorneys lien on two-thirds of the stock" and later voluntarily dismissed their appeal.

As stated by the District Court:

"Moreover, the October 14th order modifying rights in the stock is unassailable. 11 U.S.C. Section 616(1) authorizes reorganization plans under Chapter X to alter the rights of stockholders. A bankruptcy court has

the further equitable power to subordinate the stock claims of negligent directors or directors who breach fiduciary duties owed to the debtor corporation, to the claims of other stockholders. In re Automatic Washer Co., 226 F. Supp. 834, 836 (S.D. Iowa 1964), aff'd 338 F.2d 1006 (8th Cir. 1964); In re Texas Portland Cement Co., 205 F. Supp. 159,162 (E.D. Tex.1962).

Stockton & Hings' retaining lien grants them no greater interest than the Bankruptcy Court accorded Greer and Harris." (R.402,403).

A LIEN CREDITOR ON CORPORATE STOCK WHO HAS NOT FORECLOSED CAN OBTAIN NO GREATER RIGHTS THAN THE STOCK OWNER.

At the very outset of the corporate reorganization proceedings, petitioner, Stockton & Hing stipulated in writing as follows:

> "That the firm of Stockton & Hing claims a possessory or retaining lien on the stock mentioned above to secure attorneys fees, for which a claim has been filed herein.(R.2)"

Pursuant to that stipulation, the United States District Court entered the following order:

> " . . . . that respondent Robert Ong Hing and Stockton & Hing, and Judith N. Boccaccio have no ownership interest in the stock of Southwest Restaurant Systems, Inc., nor any right to vote any of the shares of stock of said corporation in these proceedings."

The above order became final and is conclusive as to petitioner's interest in the stock of the debtor corporation. Petitioner being a lien claimant who has not at anytime acquired ownership of the stock, can obtain only such rights as the owner of the stock has. The rights of lienholders whether by common law or Uniform Commercial Code are derivative. Greer and Harris, the stockholders, held their stock subject to the power of the Bankruptcy Court to modify their stock interest. As lienholders, Stockton & Hing would have no greater rights in the stock than its owners Greer and Harris. Furthermore, in this case, Stockton & Hing were a party to the proceedings leading to the confirmation of a plan of reorganization which they are unquestionably bound by. As stated by the 9th Circuit Court of Appeals:

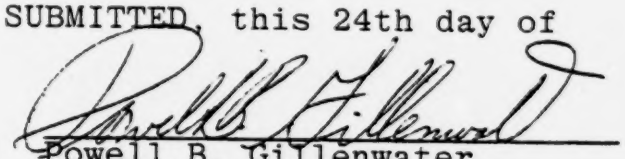
"There is little dispute that the Bankruptcy Court was authorized to alter the rights of the stockholders under Chapter X reorganization plans. U.S.C. 616(1); Additionally, there is no question but that the Court could offset the judgments of the debtor corporation against Greer and Harris in ordering the distribution. Because Stockton & Hing's retaining lien does not give the law firm an interest greater than that of Greer and Harris, we affirm the District Court's conclusion that the law firm was not entitled to any part of the distribution proceeds."

CONCLUSION

The order entered determining that petitioners had no ownership interest in the debtor stock based on petitioner's own stipulation has become final and is binding on petitioner. The order confirming the debtor's plan based on two-thirds approval of all creditors and stockholders became final and is binding upon petitioners.

Petitioners being lienors on the stock of Greer and Harris can obtain no greater rights through that stock than those possessed by Greer and Harris.

RESPECTFULLY SUBMITTED, this 24th day of January, 1980.



Powell B. Gillenwater,
attorney for respondent
of:

GILLENWATER & MEYERS, P.C.
3242 North 16th Street
Phoenix, Arizona 85016

CERTIFICATE OF SERVICE

I hereby certify that on the 24th day of January, 1980, three copies of Respondent's brief in Opposition to Petition for Writ of Certiorari were mailed, postage prepaid, to:

Russell S. Olds, Esquire
STOCKTON & HING
234 North Central Avenue, Suite 507
Phoenix, Arizona
Attorneys for Petitioner

Powell B. Gillenwater,
GILLENWATER & MEYERS, P.C.
3242 North 16th Street
Phoenix, Arizona 85016
Attorney for Respondent

STATE OF ARIZONA)
) ss:
County of Maricopa)

SUBSCRIBED AND SWORN TO BEFORE ME this 24th day of January, 1980.

Notary Public

My Commission Expires:

My Commission Expires June 7, 1982